STATE OF CALFORNIA

ELECTRICITY OVERSIGHT BOARD

Gray Davis, Governor

February 25, 2002

HAND DELIVERED

Hon. Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, D.C. 20426

Re: California Electricity Oversight Board v. Sellers of Energy and Capacity Under Long-Term Contracts with the California Department of Water Resources
Docket No. EL02- _____-000

Dear Ms. Salas:

Enclosed for filing are one original and 15 copies of the California Electricity Oversight Board's ("Board") Complaint, Volumes 1 through 5. Please file endorse the extra copies and return it to the messenger.

I also enclose a 3 ½ inch diskette in ASCII format, which contains a form of notice suitable for publication in the *Federal Register* as required by Rule 206(b)(10). 18 C.F.R. § 206(b)(10).

Thank you for your assistance.

Sincerely,

Grant A. Rosenblum
Staff Counsel
Electricity Oversight Board

Enclosures
cc: Parties Listed on Appendix A to the Complaint

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Electricity Oversight Board, Complainant v. Sellers of Energy and Capacity Under Long-Term Contracts With the California Department of Water Resources, Respondents	)	Docket No. EL02-____-000 **VOLUME 1**

COMPLAINT

Pursuant to Section 206 of the Federal Power Act, 16 U.S.C. § 824e, and Rule 206 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.206, the California Electricity Oversight Board ("California Board") hereby petitions the Commission for an order finding that specific rates, terms and conditions under long-term power purchase contracts between the California Department of Water Resources ("CDWR") and respondent suppliers, which were executed at the height of the California electricity crisis and tainted by market power, are unjust and unreasonable. The California Board requests that the Commission direct that the contracts be voidable at the State's option, or, less preferably, abrogated. Alternatively, the Commission should reform the contracts to reflect just and reasonable rates, terms and conditions for the duration of the contracts. The California Board also requests that the Commission establish a refund-effective date at the earliest time permitted by law. Should the Commission abrogate the contracts, the Commission must also ensure an orderly process that will allow the State of California and other load serving entities to obtain substitute supplies under just and reasonable rates, terms and conditions.

I.

SUMMARY OF COMPLAINT

During California's darkest hours[1] of the electricity crisis, the Commission's actions forced the State of California to enter into long-term power contracts at rates that reflected the well-documented market abuses of the spot energy market. Between January and April of 2001, CDWR signed virtually all of its letters of intent to enter into long term contracts to purchase a large volume of energy at a cost of $45 billion over the next 10 years.[2] This cost is dramatically unjust and unreasonable and is well above current market rates and well above cost of service rates. The California Board estimates that the contracts cost Californians approximately $13 billion dollars in excess of what the energy and capacity should have cost in a workably competitive market. Unless the Commission acts to redress these illegal contracts, California's ratepayers will be denied *both* the protections of cost of service ratemaking, *and* the purported benefits of competition that the Commission touts. Absent remediation, these contracts will burden the State's ratepayers and economy for many years to come.

At the time CDWR negotiated the vast majority of long-term contracts, prices in California's spot energy markets operated by the California Independent System Operator

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[1] CDWR began purchasing electricity pursuant to Governor Davis's emergency order on January 17, 2001. On that day and the following day, California experienced its first two days of rolling blackouts.

[2] See Section V-A. The terms and conditions of the vast majority, but not all, of contracts were agreed to during this time frame. Of the 33 contracts challenged by the California Board, all but five were negotiated between February and April, 2002. See *California State Auditor*, "California Energy Markets: Pressures Have Eased, But Cost Risks Remain," at Table 10, pp. 193-196. The report is available at http://www.bsa.ca.gov/bsa/pdfs/2001009.pdf.

Corporation (CAISO) and California Power Exchange Corporation (CalPX) spiked to extraordinary levels. Unfortunately, the Commission's efforts to mitigate prices in the spot markets during this period were completely ineffectual and actually made things worse by enhancing, rather than diminishing, seller's ability to exercise market power.

First, the mitigation measures adopted by the Commission in its November 1[3] and December 15, 2000[4] orders and later in its March 9[5] and April 26, 2001[6] orders, failed to tame the spot markets and, therefore, did not restrain prices in the long-term markets.[7] The price at which sellers were willing to offer long-term energy contracts reflected sellers' spot market expectations. Accordingly, CDWR could not avoid abusive prices tainted by market power of the then prevailing spot market - sellers simply spread the excessive rents over the entire term of the contract.

Second, by eliminating the CalPX, by imposing an underscheduling penalty in the CAISO's real-time imbalance energy market, and by issuing creditworthiness rulings that effectively required the State to become the default provider of electricity to consumers, the Commission thrust CDWR into the bilateral market. Yet, no mitigation or refund mechanism existed to protect CDWR's purchases from the bilateral market's

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3 *San Diego Gas & Electric Company, et al.,* "Order Proposing Remedies For California Wholesale Electric Markets," 93 FERC ¶ 61,121 (2000) (November 1 Order).

4 *San Diego Gas & Electric Company, et al.,* "Order Directing Remedies For California Wholesale Electric Markets," 93 FERC ¶ 61,294 (2000) (December 15 Order).

5 *San Diego Gas & Electric Company, et al.,* "Order Directing Sellers To Provide Refunds Of Excess Amounts Charged For Certain Electric Energy Sales During January 2001 Or, Alternately, To Provide Further Cost Or Other Justification For Such Charges," 94 FERC ¶ 61,245 (2001) (March 9 Order).

6 *San Diego Gas & Electric Company, et al.,* "Order Establishing Prospective Mitigation And Monitoring Plan For The California Wholesale Electric Markets And Establishing An Investigation Of Public Utility Rates In Wholesale Western Energy Markets, " 95 FERC ¶ 61,115 (2001) (April 26 Order).

acknowledged anti-competitive forces. In contrast, while the Commission's mitigation measures were entirely ineffectual at that time, transactions through the CAISO and CalPX were, at least, subject to refund and are now being addressed before Judge Birchman in EL00-95-045.

Third, by allowing sellers to be paid at prices above the then relevant proxy price caps, the Commission created an incentive for market participants to benefit from manipulating their cost inputs. In particular, electricity sellers had an incentive to distort the natural gas spot market and the spot prices for natural gas spiked dramatically during this same time period. Since many generators purchase natural gas from an affiliate, the gas affiliate could simply start charging the generating affiliate an inflated price regardless of the actual cost of the natural gas. Generators could then justify high electricity prices because of high natural gas costs and retain excess profits. As noted above, as long as sellers could exercise market power in the spot market, sellers would be in a position to extract monopoly rents in prices offered for long-term contracts as well.

Fourth, during the period the March 9 and April 26 Orders were in effect, the Commission calculated a proxy price using market indexes for the price of natural gas and the cost of Regional Clean Air Incentives Market (RECLAIM) emissions trading credits (RTCs). Because the published index prices are based on voluntary reporting of very limited numbers of transactions, market participants could and did exercise market power to inflate these numbers, which, in turn, inflated the relevant proxy price cap

[7] The Commission has recognized that market power in the spot markets translates to market power in long-term contracts noting in its November 1 Order that "higher spot prices in turn affect the prices in forward markets." November 1 Order at 61,367.

allowing sellers to retain inflated profits without providing cost justification.[8] Again, because market participants were able to manipulate spot prices, sellers were also able to charge excessive prices for prices for long-term energy.

Recent events also demonstrate that traders, including, but not limited to, Enron, likely manipulated prices in the forward and spot markets. Enron, for example, had at least two unique opportunities to manipulate forwards and futures market prices. First, Enron could use its dominance in these markets, which are notoriously thin particularly in the "out" years (i.e. a time window extending beyond one-year), to exert market power. Second, Enron served a unique role in EnronOnline, as either a buyer or seller of each transaction, to drive up forward energy prices in an effort to realize speculative earnings on its long-term positions.

Finally, the contracts include several onerous non-price terms and conditions that unfairly burden CDWR, the economy of California and its ratepayers. These include, among others: draconian damages in the event the contracts were challenged and found to be unlawful by the Commission; asymmetrical credit treatment; asymmetrical termination provisions; and a "most-favored nation" clause, which would ensure that all sellers would benefit from any seller-favorable term negotiated by any individual seller.

The Commission has a statutory responsibility to ensure just and reasonable rates, terms and conditions and should order that the contracts be made voidable at the State's option, within 120 days of issuing an order granting relief, or abrogate the contracts in their entirety following a similar notice period. In the alternative, the Commission should

[8] The Commission corrected these errors in its June 19 Order. *San Diego Gas & Electric Company, et al.,* "Order On Rehearing Of Monitoring And Mitigation Plan For The California Wholesale Electric Markets, Establishing West-Wide Mitigation, And Establishing Settlement Conference," 95 FERC ¶ 61,418 (2001)

reform the price terms of these contracts, and void all illegal and/or unfair non-rate terms and conditions.

II.

COMMUNICATIONS AND DESCRIPTION OF PARTIES

A. The California Board

The California Board is an agency of the State of California and was established to protect public interests concerning the restructured electricity industry. In embarking upon the transition of the electricity industry to a market structure, the Legislature created the California Board in recognition of the need to ensure "that the change in the locus of responsibility for reliability [from vertically integrated public utilities to the California Independent System Operator Corporation] does not expose California citizens to undue economic risk in connection with system reliability."[9] Accordingly, the California Board was granted authority to participate in proceedings "related to the wholesale market for electricity to ensure that the interests of California's citizens and consumers are served, protected, and represented in relation to the availability of electric transmission and generation and related costs."[10] In addition, the California Board's statutory responsibilities include oversight of the CAISO, the energy and ancillary services markets administered by the CAISO, and the reliability of the CAISO-controlled electricity grid.

(June 19 Order). The Commission appropriately removed emissions costs entirely from the calculation of the proxy price and substituted a monthly average index price for gas rather than daily average index price.

[9] Cal. Pub. Util. Code § 334.

[10] Cal. Pub. Util. Code §§ 335(e) and 341(m).

The principal office of the Board is located at 770 L Street, Suite 1250, Sacramento, California, 95814. All pleadings, orders, correspondence and communications regarding this complaint should be directed to the following persons:

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B. Respondents

Each respondent is a jurisdictional seller of wholesale electric energy to the CDWR pursuant to long-term power purchase contracts.[11] A list identifying each particular respondent is attached as Appendix A. All contracts contested in this proceeding are included in Volumes 2 – 5 filed herewith.

III.

BACKGROUND

A. The Role of CDWR in California's Energy Markets

As of January 2001, the CDWR has assumed the role of purchasing a significant portion of California's energy requirements. Several significant events in California's energy markets, including the worsening financial condition of the State's investor-owned utilities (IOUs), particularly Pacific Gas & Electric Co. (PG&E) and Southern California Edison Company (SCE), and the demise of the CalPX, required the State to take dramatic and unprecedented actions to keep the lights on.

[11] 16 U.S.C. § 824.

The California IOUs' desperate financial condition evolved as a result of the ballooning debts they incurred purchasing electricity at extremely high wholesale prices through the CalPX and the CAISO during the summer and fall of 2000 while operating under a frozen retail-rate structure.[12] By mid-January 2001, Moody's Investors Service (Moody's) and Standard & Poor's Corporation (S&P) lowered the credit and debt rating of SCE to "near junk" or "junk" status, and the credit rating of PG&E to junk status. On April 6, 2001, PG&E filed for Chapter 11 Reorganization in the U.S. Bankruptcy Court.

Due to lack of creditworthiness of the IOUs, the CDWR was required to step in as purchaser for the IOUs "net short" needs; that is, the energy demand of the IOUs' load that could not be met by the IOUs' retained generation (including production under QF contracts) and power contracts. Indeed, the Commission precluded the IOUs' from scheduling demand in excess of the amount that could be met with retained generation and required a creditworthy party, such as CDWR, to back every transaction in California's energy markets.[13]

On January 17, 2001, Governor Gray Davis issued an emergency order giving the CDWR the authority and responsibility to negotiate contracts and make arrangements for the sale and purchase of electricity to help the State mitigate the effects of the electrical shortage.[14] CDWR began purchasing energy pursuant to this authority the next day. On

[12] In April 2001, PG&E estimated spending $9 billion in unrecovered wholesale power purchases since June 2000 (Pacific Gas & Electric Company, Press Release April 6, 2001). In November 2000, SCE estimated spending $2.6 billion in unrecovered wholesale power purchase costs (Southern California Edison Press Release, November 17, 2000).

[13] *Order Addressing Creditworthiness Tariff Provisions Proposed By The California Independent System Operator And California Power Exchange*, 94 FERC ¶ 61,132 (2001); *Order Denying Rehearing of California ISO Creditworthiness Order*, 95 FERC ¶ 61,391 (2001).

[14] Proclamation, Cal. Gov. (Jan. 17, 2001).

January 19, 2001, the Governor signed legislation that appropriated $400 million from the State's General Fund for CDWR purchases for sale to SCE and PG&E.[15] On February 1, 2001, Governor Davis signed legislation (AB 1X) expanding the authority of CDWR to purchase energy on behalf of the retail customers of the state's IOUs.[16] AB1X also provides a funding mechanism for the CDWR power procurement program comprised of charges to the IOU's ratepayers and bond issuance.

At the same time that CDWR was struggling to meet the "net short" needs of state's IOUs, the CalPX closed its Day-Ahead and Day-Of markets as a result of the Commission's December 15 Order which prohibited the IOUs from either selling into or buying from the CalPX. As of January 30 and 31, 2001, the CalPX suspended all trading in its Day-Ahead and Day-Of Markets, respectively.[17] The last day of trading in the CalPX's Day-Ahead Market was January 30, 2001 and the last day of trading in the CalPX's Day-Of Market was January 31, 2001. The CalPX filed for bankruptcy protection on March 9, 2001.

When the CDWR began purchasing the net short position in January 2001, it immediately became responsible for over one-third of the IOUs' power requirements and spent more than $50 million per day on power purchases (spending over $1 billion per month for the first few months).[18] Initially, due to the demise of the CaPX and the

[15] SB X1 7, Stats. 2001 Ch. 3 (adding § 200 to the Cal. Water Code).

[16] ABX1 1, Stats. 2001 Ch 4, adding Cal. Water Code §§ 80000-80270.

[17] January 30, 2001, letter from James H. McGrew, Counsel for California Power Exchange Corporation, to the Honorable David P. Boergers, Secretary, Federal Energy Regulatory Commission, regarding Docket Nos. EL00-95-000 et al.

[18] California State Auditor Bureau of State Audits. "California Energy Markets: Pressures Have Eased, but Cost Risks Remain." December 2001, p. 27.

Commission's imposition of a 5% scheduling penalty,[19] CDWR was forced to buy a huge volume energy through bilateral arrangements on a day-to-day and hour-to-hour basis. The IOUs' net-short need was estimated in July 2001 to be about 16,300 megawatts of peak capacity (39 percent of the total utility peak demand of 42,100 megawatts).[20] At the same time, CDWR began to negotiate long-term contracts at an urgent pace in an effort to ensure reliability and to avoid the mercenary prices in the spot markets. To date, CDWR has entered into long-term contracts for power with an estimated cost of approximately $45 billion over the next 10 years. The terms and conditions of the vast majority of these contracts were negotiated in February and March 2001 during the height of the electricity crisis. These contracts represent approximately 32 percent of the energy requirements for the IOUs over the next 10 years.[21]

B. Market Power Abuse in California's Energy Markets

By the time that CDWR's role as energy purchaser on behalf of the IOU's customer base commenced in early 2001, the Commission had already found that the California markets were in disarray and plagued by the rampant abuse of market power. Moreover, the Commission had also already found that the market power abuse that infected California spot market could affect its forward energy market transactions as well. Unfortunately, but not surprisingly, market power abuse is reflected in the unjust and unreasonable terms and conditions levied by public utility sellers into their long-term power contracts with CDWR.

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[19] December 15 Order at 62,002-004.
[20] *Id*
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[21] *Id*. at 11.

Beginning with its November 1 Order, the Commission has repeatedly reiterated that the California energy markets were not workably competitive and produced prices that are unjust and unreasonable. In its July 25 Order,[22] the Commission ordered refunds for purchases through the spot markets operated by the CAISO and CalPX. The November 1 Order found that the market structure and rules for wholesale electric power transactions in California were "seriously flawed" and that "there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates under the FPA."[23]

Moreover, the Commission recognized the potential that California's forward energy markets may be impacted by the market power abuses that overwhelmed California's spot markets. The Commission found that the tight supply conditions persisting in California conferred market power even on small suppliers, and acknowledged that market power in the spot markets affects the prices in forward markets:

> This leaves California vulnerable to price spikes caused by even small suppliers who, under tight supply conditions, can affect the PX and ISO market clearing prices. These conditions can allow the exercise of market power. *These higher spot market prices in turn affect the prices in forward markets*.[24]

In its December 15 Order, the Commission "reaffirmed [its] earlier finding that current market conditions in California leave participants with the potential to exercise

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[22] *San Diego Gas & Electric Company, et al.,* "Order Establishing Evidentiary Hearings Procedures, Granting Rehearing in Part, and Denying Rehearing in Part," 96 FERC ¶ 61,120 (2000) (July 25 Order).

[23] November 1 Order at 61,349-350.

[24] November 1 Order at 61,367 (emphasis added).

market power because of flawed market rules and tight supply conditions, which may lead to rates that are not just and reasonable."[25] The Commission further stated that "Moreover, going forward, we had no assurance that rates will not be excessive relative to the benchmarks of producer costs or competitive market prices … Therefore, we reaffirm our findings that unjust and unreasonable rates were charged and could continue to be charged unless remedies are implemented. "[26] The Commission recognized that if "rates do not behave as expected in a competitive market, the Commission must step in to correct the situation."[27]

In its initial November 1 Order, the Commission proposed a package of "structural" remedies for the California markets, and proposed to implement a $150 "soft" price cap effective January 1.[28] Suppliers who sold at prices above $150 would receive their bid price rather than setting a market clearing price, and would be required to report certain information to FERC. The fundamental "remedy" in the Commission's proposal was to require buyers to increase their forward market purchases and decrease their spot market purchases. To enforce this, buyers who procured more than 5% of their requirements in the real-time market would be assessed an "underscheduling penalty" of $100/MWh.[29] The December 15 Order implemented, largely unchanged, the price mitigation proposals set forth by the Commission in the November 1 Order. However, as described below in Section V-B of this Complaint, these price mitigation policies adopted

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[25]December 15 Order at 62,011.

[26] *Id.*

[27] *Id.* at 61,998 and n.44.

[28] November 1 Order at 61,350-351.

[29] *Id*. at 61,360-362.

by the Commission in its December 15 Order actually exacerbated the effect of market power in California's energy markets which is reflected in the long-term power contracts entered into between those sellers and CDWR.

Following the November 1 and December 15 Orders, and in continued recognition of California's energy market dysfunction and the ineffectiveness of the market mitigation measures adopted to date, the Commission issued the March 9 and April 26 orders as it struggled to find some means for effective mitigation. However, the March 9 and April 26 Orders managed to worsen matters in California's energy markets by substantially reducing the scope of the December 15 Order mitigation plan (flawed as it was), by further limiting potential refunds to sales transacted through the CAISO's spot markets only during reserve deficiency hours.[30]

The March 9 Order provided that potential refunds would be limited to hours in which the CAISO declared a Stage 3 system emergency (per WSCC criteria) and established a threshold for potential refunds based upon a proxy market clearing price (to be calculated by the Commission each month) based on the hypothetical operating cost of an expensive generating facility operating on the margin in California. The hypothetical operating cost included the published price indexes for RECLAIM trading credits and daily natural gas costs. The Commission set a proxy price of $273/MWh for January; $430/MWh for February; $300/MWh for March and $318/MWh for April – prices significantly higher than the $150/MWh set forth in the December 15 Order.

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[30] The California Board has asserted, and continues to contend, that the FPA imposes on the Commission the obligation to extend refund liability to unjust and unreasonable transactions, whether in the spot or long-term markets or whether bilateral or through an organized auction.

The Commission, recognizing the inadequacy of the March 9 Order by limiting its review only to hours in Stage 3 conditions, extended a slightly revised proxy mitigation in its April 26 Order to all hours under emergency conditions (i.e. Stage 1, 2 and 3 conditions) when reserves fall below 7.5%.[31] The April 26, 2001 Order also addressed generation facility outage and coordination, established a must-offer requirement for sellers, required the development of demand response mechanisms.

In its June 19 Order, the Commission again reaffirmed that unjust and unreasonable prices continued to be charged for the six months following the December 15 Order, and recognized that its prior orders had been insufficient to remedy the market power producing unjust and unreasonable prices.[32] The June 19 Order broadened price mitigation to include all hours regardless of the existence of a staged emergency,[33] and provided that price mitigation would remain in place through September 2002, rather than terminate within one year.[34] It was only with the June 19 Order that the Commission finally adopted a mitigation mechanism that provided truly effective mitigation on a going forward basis. Unfortunately, although the Commission has ordered relief in the form of refunds for spot purchases made between October 2, 2000 and June 19, 2001, no relief currently applies to long-term contracts negotiated during this time frame.

[31] The CAISO actually issues Stage 1 Emergency warnings when reserves fall below 7%.

[32] June 19 Order at 62,557-558 (expanding mitigation program announced in April 26 Order to attempt to produce "spot prices in all hours that are just and reasonable").

[33] *Id.* at 62,548.

[34] *Id.* at 62,567.

IV.

APPLICABLE STANDARD OF REVIEW

A. Market-Based Rates May Be Authorized Only Where The Resulting Charges Fall Within The Zone Of Reasonableness

The primary responsibility of the Commission is to "guard the consumer against excessive rates." *City of Detroit v. FPA,* 230 F.2d 810, 817 (D.C. Cir. 1956). Rates for wholesale power must therefore be "just and reasonable." 16 U.S.C. §§ 824d, 824e. Accordingly, the Commission has the duty—not the option—to reform rates that are not just and reasonable or, stated differently, that fall outside a "zone of reasonableness" within which rates are high enough to be compensatory to the utility but not excessive for the consumer. *FPA v Hope Natural Gas Co.,* 320 U.S. 591, 602-603, 610-612 (1944).

The FPA fails to prescribe how just and reasonable rates must be determined. What is clear is that mere deference by the Commission to prevailing market prices represents an impermissible abandonment of its regulatory obligations under the FPA. *FPC v. Texaco,* 417 U.S. 380, 397 (1974). However, reliance by the Commission on market-based rates in lieu of a traditional cost-of-service analysis has been approved, but only where the Commission can make sufficient findings that the relevant market is, in fact, competitive. *Elizabethtown Gas Company v. FERC,* 10 F.3d 866, 870 (D.C. Cir. 1993).

The court in *Elizabethtown*, for example, upheld the Commission's approval of market-based rates for gas sales by a natural gas pipeline on the ground that the Commission had "specifically found" that gas markets "were sufficiently competitive to preclude [the pipeline] from exercising significant market power" such that the pipeline would "not be able to raise its price without losing substantial business to rival sellers." *Id.* at 871. It is precisely "[s]uch market discipline [that] provides strong reason to believe [the seller] will be able to charge only a price that is 'just and reasonable.'" *Id.* Thus, where the Commission permits market-derived pricing, the Commission must have "empirical proof" that "existing competition [did] ensure that the actual price is just and reasonable." *Farmers Union Central Exchange, Inc. v. FERC,* 734 F.2d 1486, 1503 (D.C. Cir. 1984); see also, *Tejas Power Co. v. FERC,* 908 F.2d 998, 1005 (D.C. Cir. 1990).

True competitive markets produce just and reasonable rates because, like rates determined on the basis of the seller's cost-of-service, competitive market prices will fall within the zone of reasonableness by approximating the seller's actual costs plus a reasonable return on capital. As the D.C. Circuit explained:

> In a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable, and *specifically to infer that the price is close to marginal cost, such that the seller makes only a normal return on its investment.*

Tejas Power Corp. v. FERC, 908 F.2d at 1004.

Accordingly, while the Commission possesses discretion in selecting ratemaking methods, the determination whether rates fall within the zone of reasonableness must be measured against the costs incurred by the seller. "Because the relevant costs, including the cost of capital, often offer the principal points of reference for whether the resulting rate is 'less than compensatory' or 'excessive,' the most useful and reliable starting point for rate regulation is an inquiry into costs." *Farmers Union Central Exchange, Inc. v. FERC,* 734 F.2d at 1502; see also, *City of Chicago v. FPC,* 458 F.2d 731, 751 ["[W]hen the inquiry is whether a given rate is just and reasonable to the consumer, the underlying concern is whether it is <u>low</u> enough so that exploitation by the producer is prevented …

[N]o factors apart from the producers' costs are available to guide efforts to make that determination from the standpoint of consumers." (emphasis in original).]

Market-based rates may be just and reasonable only when produced by a sufficiently competitive market. Here, the Commission has determined that the California electricity market during the period in which the Contracts were negotiated was dysfunctional and not truly competitive. The Commission has further acknowledged that unjust and unreasonable prices in the California spot market tainted forward prices. Under such circumstances, refunds must be ordered for unjust and unreasonable sales even in the absence of finding that any particular seller had, in fact, exercised market power. *Transmission Access Policy Study Group v. FERC,* 225 F.3d 667, 687-688 (D.C. Cir. 2000); see also, July 25 Order. The existence of generalized systemic conditions that provide the opportunity for anticompetitive behavior is sufficient. Commission and judicial precedent, therefore, compels the conclusion that the rates and terms reflected in the Contracts, which bear no resemblance whatsoever to the outcomes of a competitive market, are unjust and unreasonable and are subject to remediation.

A. The California Board's Complaint Is Not Barred By The *Mobile-Sierra* Doctrine.

The *Mobile-Sierra* doctrine restricts the Commission's ability in a Section 206 proceeding to modify the rates or conditions under Commission-approved long-term negotiated contracts unless the subject rate or condition is found to be contrary to the "public interest."[35] Many of the challenged contracts explicitly purport to force the Commission to apply the *Mobile-Sierra* public interest standard in any review

[35] See *United Gas Pipe Line Co. v. Mobile Gas Serv.,* 350 U.S. 332 (1956); *FPC v. Sierra Pacific Power Co.,* 350 U.S. 348 (1956).

proceeding.[36] Even with respect those contracts silent on the appropriate standard of review, each respective supplier will also likely seek refuge in the stringent public interest standard. However, under well-established Commission precedent, the *Mobile-Sierra* doctrine does not apply (1) to contracts being reviewed by the Commission for the first time or (2) to challenges by third party non-signatories to the contracts. Thus, contrary to both the contractual provisions and the self-serving pleas of suppliers, the Mobile-Sierra doctrine does not insulate the contracts from meaningful review under Section 206's general "just and reasonable" standard in this proceeding.

1. The Public Interest Standard Does Not Apply to Contracts Being Reviewed By The Commission For The First Time.

Florida Power & Light, 67 FERC ¶ 61,141 (1994) unequivocally declared that "[t]he Commission is not in any circumstance bound, absent its consent, to a public interest standard of review when the Commission reviews a contract initially." Simply put, the Mobile-Sierra doctrine does not relieve the Commission its statutory obligations. The doctrine "does not affect the supremacy of the [FPA] itself." Accordingly, the Commission must be granted "an opportunity in every case to judge the reasonableness of the rate." *Arkansas Louisiana Gas Company v. Hall,* 453 U.S. 571, 582 (1981). Acceptance of a contrary rule would impermissibly allow parties to "evade meaningful

[36] For instance, in Calpine 1 (Exhibit 2), § 10.14 states, in pertinent part: "The terms and conditions and the rates or service specified herein shall remain in effect for the term of this Agreement and the related Transaction and shall not be subject to change through application to the Federal Energy Regulatory Commission by either Party, including the State of California and any of its agencies, pursuant to the provisions of Section 205 or 206 of the Federal Power Act. Each party expressly agrees that it will not make any filings under either Section 205 or 206 of the Federal Power Act to revise the rate schedule. If, however, a third party should make such a filing, the proponent will be required to meet the public interest standard as expressed in the *Mobile-Sierra* doctrine under Section 206 of the Federal Power Act and *Potomac Elec. Power Co. v. FERC,* 210 F.3d 403, 409-10 (D.C. Cir. 2000)." See also, Mirant (Exhibit 11), § 6, and Allegheny (Exhibit 32), §10.13(c).

regulation and thereby negate Congress' consumer protection objectives." *Florida Power & Light,* 67 FERC ¶ 61,141.

The Commission has not reviewed any of the contracts at issue for justness and reasonableness. In response to a protest by the California Public Utilities Commission to the filing of the GWF long-term contract, the Commission stated:

> While we require that long-term power sales agreements entered into pursuant to previously granted market-based rate authority be filed with the Commission, these filings are not traditional Federal Power Act (FPA) section 205 filings, but rather are informational filings submitted in response to the filing requirements found in the orders granting market-based rate authority. While we require these filings to be submitted on a timely basis and we routinely issue acceptance orders on such submittals … , we are not required by the FPA to act on such filings … . Further, we are not required to find that such agreements themselves are just and reasonable….

GWF Energy, LLC, et al., 97 FERC ¶ 61,297 (2001) [footnotes omitted]; see also, *PacifiCorp Power Marketing, Inc.,* 97 FERC ¶ 61,105 (2001). The public interest standard of review, therefore, is inapplicable.

2. Neither The California Board Nor The Consumers It Represents Are Parties To The Contract.

Contractual provisions cannot unilaterally impose the public interest standard on third-party non-signatories to the contract. Non-parties must simply demonstrate that the challenged rate provisions are unjust and unreasonable under section 206. The Commission recently held:

> Mobile-Sierra does not speak to situations such as this, where a non-party to the RAA [Reliability Assurance Agreement] (such as PJM, which is not a signatory to the RAA) seeks changes under section 206. [n13] Under PPL's interpretation, parties to a contract who agree among themselves not to seek rate changes would be able to bind not only one another, but also other entities who are not parties to that contract (and did not receive the contractual

> benefits in exchange for which the parties traded away their right to seek rate changes). This result is not what the Supreme Court intended in Mobile-Sierra.
>
> Most decisions involving Mobile-Sierra, unlike the case before us, involve a request by one of the signatories to the contract at issue seeking to change the terms of the contract. That is a very different situation….

PJM Interconnection, LLC, 96 FERC ¶ 61,206 (2001).

Indeed, the Commission identified only one circumstance in which parties to a contract can compel the Commission to employ the public interest standard: (1) where the parties bind both themselves and the Commission and (2) the public interest standard of review applies only to future attempts of the parties (or the Commission acting sua sponte on behalf of the parties) to depart from the contractual bargain contained in the contract that has previously been accepted by the Commission. *Southern Company Services, Inc.*, 67 FERC ¶ 61,080 at 61,227 (1994). In that narrow circumstance alone, the Commission without its consent may be bound to the public interest standard of review.[37]

The California Board is not a signatory to any of the CDWR contracts. Nor did it participate in negotiations defining the arrangements. Thus, the Mobile-Sierra doctrine does not apply. Moreover, notwithstanding the illegality of provisions attempting to deprive all state agencies of the ability to challenge the contracts, these contract provisions do not, and cannot, extinguish the California Board's statutory obligation to

[37] The Commission has expressly recognized the circumscribed application of the Mobile-Sierra doctrine with respect to the long-term contracts of CDWR. In the December 15 Order, the Commission stated that to "address concerns about any potentially unjust and unreasonable rates in the long-term markets, we will monitor prices in those markets and also adopt a benchmark that we will use as a reference point in addressing any complaints regarding the pricing of long- term contracts negotiated over the next year." In its July 25 Order, the Commission again stated that "[i]f DWR (or any other party) believes any of its contracts are unjust and unreasonable, it may file a complaint under FPA section 206 to seek modification of such contracts."

represent the interests of the State of California in protecting the State's economy and consumers.[38]

V.

MARKET DISTORTIONS AND ANTI-COMPETITIVE BEHAVIOR LEFT CDWR NO CHOICE BUT TO ENTER INTO UNJUST AND UNREASONABLE CONTRACTS

A. Market Power In California's Spot Markets Distorted Longer-Term Power Markets

At the time CDWR was thrust into the role of securing power for the net short position of the IOUs, California's electricity crisis was reaching a devastating crescendo. The average price for spot energy in the CAISO's real-time energy markets was $447.51 for the week ending February 16, 2001 and by March 9, 2001, despite the Commission's insufficient efforts at mitigation, the average price had barely receded to $384.51. The State's General Fund was hemorrhaging as California spent over $500 million in January and $1.4 billion in February for short-term power.

The Commission had repeatedly recognized that the exorbitant prices experienced by California were the product of dysfunctional energy markets that fostered the exercise of market power: "there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates under the FPA."[39] More importantly, the Commission has acknowledged the well-established interdependence between the spot

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[38] The California Board is authorized by statute to represent its citizens in litigation before this Commission "related to the wholesale market for electricity to ensure that the interests of California's citizens and consumers are served, protected, and represented in relation to the availability of electric transmission and generation and related costs, during periods of peak demand." (Cal.Pub.Util.Code §§ 335(e) and 341(c).)

[39] November 1 Order, 93 FERC ¶ 61,121 at 61,349-350; December 15 Order, 93 FERC ¶ 61,294 at 62,011.

market and longer-term forward markets by noting that the tight supply conditions persisting in California conferred market power even on small suppliers in the spot market, and the resulting higher spot market prices drove up forward market prices:

> This leaves California vulnerable to price spikes caused by even small suppliers who, under tight supply conditions, can affect the PX and ISO market clearing prices. These conditions can allow the exercise of market power. *These higher spot market prices in turn affect the prices in forward markets*.[40]

More recently, in the June 19 Order, the Commission further linked spot market behavior to long-term forward prices.[41]

The reason unrestrained spot market prices, such as those effectively permitted by the December 15 Order, cause forward market prices to similarly explode is fundamental -- "no profit maximizing firm will voluntarily give away market power that it possesses without an up-front payment that exceeds the increased profits available from exercising this market power."[42] Thus, sellers' long-term contracts with CDWR exacted the same amount of market-power rents from California consumers that would have been exacted in the spot market— except that monopoly rents were amortized over the term of the contracts. In other words, by entering long-term contracts, CDWR was unable to avoid the abuses it would have sustained by buying in the spot market.

As noted, the spot market from January through April 2001 was exceedingly high. Correspondingly, energy futures prices energy were also distorted. The March 2001

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[40] November 1 Order at 61,367 (emphasis added).

[41] June 19 Order, at 62,556 (expanded spot market mitigation plan "will, over time, impact bilateral and forward markets as well"). See also *AEP Power Marketing, Inc.,* 97 FERC ¶ 61,219 (2001).

[42] March Market Surveillance Committee, Comments on "Staff Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electricity Markets," at 10 found at http://www.caiso.com/docs/2001/03/22/2001032214473821567.pdf.

average future prices for the twelve months forward for the COB market were in the range of $200-$450 and were sharply higher than the NYMEX futures price for the PJM market for the same period.[43] Therefore, in order to avoid paying extremely high prices for electricity to be delivered in the summer of 2001 and 2002, CDWR had to agree to supply arrangements for up to twenty years in duration.[44] However, the prices sellers were willing to offer included expected market-power-influenced profits for summer 2001 and summer 2002. Consider this example:

> Suppose a generator expects it will be able to sell electricity at prices that average $300 per megawatt hour from June 2001 through May 2002; $150 per MWH from June 2002 through May 2003; and $45 per MWH for all years after May 2003. Consider a contract that offers 1/20th of its energy in the first year, 1/10th in the second year and 17/20 in years 3 to 10. A generator offering anything less than $68.25 per MWh (0.05 x 300 +0.1 x 150 + 0.85 x 45) would be leaving dollars on the table.

In this way, many of the generators exacted anticipated monopoly rents related to the first two years and amortized them over the term of a contract that also provided a fully compensatory return for other years, with these amounts blended over the entire term of the agreement. Indeed, as discussed below, CDWR was forced to overpay approximately $13 billion. The Commission's conclusion that spot market prices have been unjust and unreasonable, along with its concession that spot prices affect forward prices, necessarily

[43] See www.ferc.gov/calendar/commissionmeetings/Discussion_papers/10-24-01/western_infrastructure_presentation.ppt.

[44] As noted by Professor Frank Wolak, Chairman of the CAISO's Market Surveillance Committee: "The extent of market power that any existing firm can exercise will be smaller the longer the time horizon between the date at which the agreement to supply electricity is reached and actual delivery takes place. Because the set of potential entrants is significantly reduced at a time horizon of less than two years--the time it takes to site and build a state-of-the-art natural gas-fired generating facility--existing firms are very likely to exercise significant market power in bilateral agreements to supply electricity at up to two years in advance of the date of delivery." Prepared Direct Testimony of Frank A. Wolak, *Puget Sound Energy, Inc. v. All Sellers of Energy, et al.*, EL01-10-000 (August 17, 2001).

lead to the conclusion that forward prices agreed to this spring by CDWR were also tainted by market power and thus are not just and reasonable.

B. The Commission's Mitigation Policies Exacerbated The Effect Of Market Power

1. By Allowing Sellers To Justify Their Costs Inputs At Levels Above The Applicable Proxy Price, The Commission Created An Incentive For Market Participants To Successfully Benefit From Manipulating Their Costs Inputs.

CDWR negotiated long-term contracts at times when the spot price and futures for electricity and natural gas were extremely high. The mitigation mechanisms in effect beginning on January 1, 2001 all allowed sellers to justify any costs above the cap or proxy prize that was in effect for the relevant period. Between January 1 and March 9, 2001, the $150 soft cap was in place. After the March 9 Order, a proxy price mechanism established the relevant cap. Because the Commission allowed cost justification above the cap, market participants had an incentive to raise gas prices in order to cost justify high electricity prices. In fact, the Commission has recognized that gas prices in California where dramatically higher than gas prices in other parts of the country. In its *Order Proposing Reporting Requirement On Natural Gas Sales To California Market And Requesting Comments,* Docket No. RM01-9-000 (May 18, 2001), the Commission acknowledged the dramatic disparity in daily gas spot prices between California and other markets.

> As reported in the May 18, 2001 Gas Daily, the most recent daily spot price for gas various points on the southern California border are in excess of $9.00, while in the producing basins and other downstream markets, the spot prices are in the $4 range. For example, the spot price for SoCal Gas, large packages was $9.60-11.00, while for El Paso Permian Basin area it was $3.80-4.08, and for Transco, New York citygate it was $4.50-4.68.

Since many generators buy natural gas from affiliates, holding company parents could retain monopoly rents by simply raising the price of gas charged to generating affiliates. For example, assume actual gas costs of $3 per MBtu and assume the generating affiliate can produce electricity at a 15,000 Btu/kWh rate and assume the $150 soft cap were in effect. The resulting cost of electricity would convert to $45 per MWh. If the generator charged $225 per MWh,[45] it would not be able to justify its gas costs and would be required to refund amounts above the cap. If, on the other hand, the gas affiliate raises its gas price to $15 per MMBtu, the generator would be able to justify its natural gas costs. In this way, sellers forced market prices for both electricity and gas above competitive levels.

2. By Destroying The CalPX And By Imposing The Underscheduling Penalty, The Commission Forced CDWR To Purchase Energy In The Untamed Bilateral Market At Prices That Were Not Subject To Refund.

As discussed above, the December 15 Order effectively destroyed the CalPX which was out-of-business by the end of January, 2001. Transactions that previously were consummated through the CalPX now had to be arranged as bilateral out-of-market transactions that were not, under the Commission's orders, subject to mitigation even though the Commission had responsibility to ensure that these wholesale prices are also just and reasonable.[46]

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[45] A bid of $225 per MWh would have been considered comparatively reasonable at the time as the vast majority of offers were well in excess of $250 per MWh.

[46] For this reason, the California Board filed a motion in these proceedings requesting that the Commission clarify that the December 15 Order mitigation extends to transactions outside the CalPX (and CAISO) including, in particular, purchases made on behalf of California consumers by the California Department of Water Resources. *See* Motion of the California Electricity Oversight Board for Clarification and Extension of Specific Aspects of the December 15, 2000 Order in Docket Nos. EL00-95-000 et al. filed on March 1, 2001. The Commission denied the California Board's motion in its July 25 Order and denied the Board's rehearing request in its December 19 Order.

In addition, the underscheduling imposed in the December 15 Order simply raised the price of electricity in the forward markets by the amount of the penalty and simply forced CDWR to purchase out-of-market in the bilateral spot market.[47] Thus, the effect of the Commission's orders to terminate the CalPX and to impose the underscheduling penalty on the CAISO's market, was to push CDWR into the unprotected, inflated forward bilateral market.

3. The Proxy Price Methodology In Effect Prior To The June 19 Order Created An Incentive For Market Participants To Successfully Benefit From Manipulating Published Daily Gas Prices And RECLAIM Credits Prices.

Prior to the June 19 Order, the Commission's proxy price calculation reflected daily spot gas prices from a published index (as opposed to actual costs or, as later adopted in the June 19 Order, a monthly average price) and the daily price of RECLAIM credits.[48] Indexes of this sort can be manipulated easily by market participants by entering into and reporting transactions that can raise the published index without significantly raising generators' own costs. In its request for rehearing of the April 26 Order, the South Coast Air Quality Management District (SCQAMD) explained how the published price of RECLAIM trading credits (RTCs) had been manipulated by a power plant at a time when power plants were no longer required to purchase RTCs in order to influence the proxy price calculating. According to SCAQMD, it observed "at least one instance of a power plant paying two to three times the market price for RTCs that have

[47] In its December 19 Order, the Commission granted numerous rehearing requests by the California Board and others to abandon the underscheduling penalty. December 19 Order, slip. op. at 7, 113-115

[48] The April 26 Order directed that the gas cost proxy be based on "an average of the daily prices published in the Gas Daily for all California delivery points." April 26 Order, slip. op. at15. The April 26 Order also directed that the CAISO include a proxy for emissions costs based on data published by Cantor Fitzgerald Environmental Brokerage Services and the emission rate for the unit. *Id*.

previously been sold . . . to an out-of-state purchaser and were then resold, at the inflated price, to the power producer. Both the sale and the inflated resale were . . . registered—on the same day—with SCQAMD."[49]

Similarly, there was no regime in place to prevent market participants from easily entering into comparable sham transactions for natural gas sales. Moreover, as noted above, the Commission acknowledged that published natural gas prices in California were artificially high. In addition, the Commission recognized the error of its ways in its June 19 Order be deleting emissions costs entirely from the calculation of the proxy price and by substituting a monthly average gas price for the daily average gas price. The CDWR contracts, however, were negotiated when prices were influenced by the prevailing, artificially high, proxy prices.

4. Marketers Possessed The Incentive To Run Up Short Term Prices And Forward Curves To Realize Markup On Forward Positions

The demise of Enron has revealed further evidence of market power and dysfunction of the power markets in California and the Western United States. The Powers Report, put together by William Powers, dean of the University of Texas Law School, found that Enron's bankruptcy was the result of a "systematic and pervasive attempt by officials to inflate profits." In part, the scheme by Enron, and possibly other energy marketers, to inflate profits relied on "mark to market" accounting. Mark to market accounting allows companies to report as current earnings profits expected to be realized in the future from forward positions they hold. Companies are permitted to estimate the fair value of the forward positions, based in large part, on forecasted market

[49] "Application of the South Coast Air Quality Management District for Limited Rehearing and Clarification and Motion for Expedited Consideration and Partial Stay" at 9-10 filed in EL00-95-012 *et al* May 29, 2001.

conditions. Thus, Enron's business model apparently relied on inflating the forward price curves relied upon by CDWR in negotiating its long-term energy contracts.[50] More importantly, Enron had at least two unique opportunities to manipulate forwards and futures market prices, particularly in the Western U.S. market.

First, Enron's dominance in the forwards and futures markets facilitated the exercise of market power and its resulting ability to raise profit expectations by forecasting high expected revenues from forward contracts. A single participant, such as Enron, can move the market price through control of a relatively large volume of transactions. Where the market is thinner and more volatile, the proportionate share of the market needed to manipulate the price is smaller. Forwards and futures markets become thinner as contracts move into the future and are substantially thinner for periods greater than one-year. For example on February 21, 2002, on the New York Mercantile Exchange market for natural gas futures at Henry Hub, March 2003 contracts totaled about 0.5% of the contracts for March 2002, only twelve months prior.

Enron had sufficient market volumes to exert control in the forward markets and had every incentive to push upward any forecasts of future market prices to support expected earnings projections. Enron reportedly participated in transactions involving 25 to 30% of all physical energy contracts in the U.S. since 1999, and, more significantly, has been suggested to have been involved in as much as 70% of the physical contracts in

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[50] As one example, Enron sold a bond at $100 million based on expected future net income from a broadband on-demand video service that Enron was developing with Blockbuster. The business had reached only about 1,000 customers, but Enron used the bond sale to book $100 million in future earnings to its current balance sheet. The expected earnings were in fact speculative, and Enron even withdrew from the business in September 2001.

the Western U.S. market.[51] Thus, because Enron controlled such a large share of the forwards market, the forecast was highly dependent on Enron's actions.

Second, Enron had the ability to manipulate forwards market prices through its operation of EnronOnline. EnronOnline put Enron in a extraordinary position to exploit market information to drive up long-term energy prices. Market exchanges generally fall into two categories. In the first, the exchange is essentially a broker or facilitator that brings buyers and sellers together, but no one at the exchange actually takes possession of the commodity. The Chicago Board of Trade and NASDAQ are examples of this type of market. In the second, the exchange or appointed agents act as dealers that simultaneously buy and sell the commodity. In other words, ultimate buyers and sellers do not interact directly with each other. The New York Stock Exchange functions in this manner, with about 80 "market makers" acting as the dealers in various stocks. EnronOnline was a dealer exchange, with a single market maker--Enron. Enron was either the buyer or seller on every transaction on the exchange. It also had a stake in many of the transactions as a buyer or seller, which is a highly unique situation in these exchange markets.[52]

In this role, Enron was in the position to know instantaneously the volume and price points for both buyers and sellers in the market. For example, in a tight supply market, Enron could have the buying operation purchase more contracts and drive up the price, then withhold some of those contracts from being transferred to the selling side of the exchange. This would drive up the selling price even further. Moreover, Enron could

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[51] Enron's role was as a middleman in these transactions; it rarely owned the physical production assets or was the final consumer.

[52] See *Order Rejecting Tariff Amendments Without Prejudice,* 96 FERC ¶ 61,093 (2001) at fn. 10.

bid high at a short-term loss to support prices and reap greater offsetting benefits in its long-term positions. Given the known analytic sophistication of Enron's market operations, moving the market in this manner with all of the controls available would appear to be a relatively simple task.

Indeed, the Commission has concurred. The Commission rejected proposed amendments of Enron Power Marketing, Inc. (“EPMI”) and Portland General Electric (“PGE”) that would allow them to make inter-affiliate sales using EnronOnline. In so doing, the Commission stated:

> Applicants contend that, since PGE can transact with EPMI via EnronOnline only at the posted price, there can be no affiliate abuse. We are not certain, however that the posted price necessarily represents the market price. While, on the surface, EnronOnline may bear some resemblance to an index or auction, the posted prices for any product may not be the result of a competitive market of multiple buyers and sellers; in fact, for sales the posted prices represent what EPMI is willing to sell at, and for purchases the posted prices represent what EPMI is willing to buy at. For other transactions through media other than EnronOnline, including other exchanges, EPMI might be willing to sell at lower prices and buy at higher prices. Moreover, Applicants provide no information about how product prices posted by EPMI are determined … .[53]

The forwards and futures market prices relied upon by CDWR in negotiating long-term power contracts were not reflective of a properly, fully functioning competitive market-place. A single player, Enron, had both the incentive and the ability to manipulate those prices upward.

[53] *Id.,* slip. op. at 4-5.

VI.

CONTRACT RATES, TERMS AND CONDITIONS ARE UNJUST AND UNREASONABLE AND AGAINST THE PUBLIC INTEREST

A. Contract Prices Are Unjust and Unreasonable

The California Board has analyzed CDWR's long-term contracts. Based on that analysis, the California Board has calculated, on a preliminary basis, that the contracts exceed a competitive benchmark price, based on a generous measure of long-term marginal costs, by more than $13 billion in nominal cost. This excess cost of $13 billion covers the ten-year period from 2001 through 2011.

The California Board first determined the total cost of the CDWR contracts based on the terms and conditions of those contracts and estimated that the total cost of the CDWR contracts for the ten-year period exceeded $45 billion. (This estimate is approximately $4 billion higher than the California State Auditor found in its *California Energy Markets* report of December 2001. The divergence is due to somewhat different assumptions underlying the Auditor's and the Board's analyses.)

The California Board then compared the contract costs with cost assumptions consistent with estimating the alternative market costs of the same amount of energy and capacity products, including peak and off peak energy and capacity. In other words, the California Board then calculated what the contracts would have cost if the California electricity market had not been dysfunctional in the Fall 2000 through Spring 2001 period during which the contracts were negotiated. Because the comparison is over a long term, ten years, the California Board based its cost analysis on the cost of new generation, i.e. long-run marginal costs, rather than short run marginal costs. Against that standard, the total cost of the CDWR contracts is $13 billion in nominal dollars (or $11 billion discounted for present value) greater than what would have been expected had the California energy markets performed competitively. (If the California Board had used a short run marginal cost standard, the amount would have substantially exceeded the $13 billion figure.)

The California Board used the cost of a new unit, i.e. long run marginal costs, for the purpose of estimating the price that would be observed in a competitive market over the long-term. Doing this is proper, and rests on well-accepted economic principles. In a growing competitive market, the equilibrium price, in the long run, assuming the market did not over invest, causing a glut that would put substantial downward pressure on prices, would equal the cost of expanding output. This is, however, a generous measure and prices the power supplied within the near term (i.e. the first two years) based on long-term costs. Further, because sellers receive the same price in a competitive market, the California Board assumed that all sellers would receive the same price. The following table summarizes the California Board's cost calculations:

Table of Costs and Cost Excess

	CDWR Contract Energy GWhs	CDWR Contract Costs $millions	Competitive Benchmark Costs $millions	Excess: CDWR minus Benchmark $millions
2002	47,252	4,063	2,071	2,094
2003	63,528	4,896	2,839	2,397
2004	80,585	5,434	3,672	2,337
2005	68,489	4,496	3,183	1,927
2006	71,274	4,502	3,379	1,773
2007	71,274	4,519	3,448	1,734
2008	71,274	4,546	3,518	1,703
2009	71,274	4,572	3,591	1,670
2010	70,393	4,546	3,620	1,619
2011	60,849	3,840	3,195	1,256
	Nominal Cost in $ billions	45,414	32,517	12,897
	Present Value in $ billions			10,953

These calculations are based on the following assumptions:

- The cost differences were discounted 5 % to determine the 2002 present value This approximates the rate that would apply to CDWR for borrowing on a 10 year basis.
- The cost of gas is a primary assumption for both the level of the contract costs and the costs of the alternative standard. The California Board used the current cost of approximately $3/MMBTU and escalated it at 3% over the term.
- The competitive market standard required specific assumptions as to what generation would have served as a price alternative. The California Board calculated the cost of a new combustion turbine (CT)[54] and a new combined cycle (CC).[55] The energy was divided between the CT and CC approximately as it would be delivered on a peak-period or on a baseload basis. (While the majority of the energy from the Contracts is baseload, there still was a considerable portion that would be delivered on an on-peak basis.)

The $13 billion in monopoly rents, based on generous cost assumptions, constitutes nearly 30% of California's entire costs under the long-term contracts over the next 10

[54] The cost characteristics for a new CT are as follows:
- construction costs of $400/ kW (130 MW unit);
- $15/kW-year fixed O&M plus roughly 85% of same for property taxes and local fees;
- $5/MWh for variable O&M;
- heat rate of 10.5 MMBTU/MWh; and
- 75% debt with a 1.45 coverage ratio.

[55] The cost characteristics for a new CC are as follows :
- construction costs of $600/ kW (400+ MW unit);
- $15/kW-year fixed O&M plus roughly 85% of same for property taxes and local fees;
- $3/MWh for variable O&M;
- heat rate of 7.5 MMBTU/MWh; and
- 75% debt with a 1.45 coverage ratio.

years. Market power is the ability to raise market price above the competitive level.[56] While one can argue that very brief price spikes may be consistent with a competitive market, the same cannot be credibly advanced with respect to the magnitude and duration of the failure in California's electricity wholesale market or the magnitude and duration of excess charges reflected in the CDWR contracts. The extent of the excess rents demanded by the suppliers here clearly manifests the exercise of market power and necessarily renders the contract price terms unjust and unreasonable.

B. Unlawful And Unreasonable Non-Price Terms And Conditions

Market power distorted more than the price terms for energy and capacity under the CDWR contracts. Certain non-price terms of the contracts are also unjust and unreasonable and should be subject to abrogation and/or revision by the Commission. See *Transmission Access Policy Study Group v. FERC,* 225 F.3d 667, 709-712 (D.C. Cir. 2000).

1. Block Contracts Dispatchability Problems

A massive quantity of electricity was purchased by CDWR from fossil fuel fired plants in blocks (12 x 24 and 6 x 16). The California State Auditor estimates that of the 58,394 megawatts of capacity secured by the contracts over the next 10 years, 45,480 megawatts, or 78%, are in the form of block products that are non-dispatchable.[57] Non-dispatchable energy contracts, also known as "take or pay" contracts, require the buyer to pay for the power regardless of whether the power is needed.

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[56] See *Strawman Discussion Paper for Market Power Monitoring and Mitigation Panel Technical Conference on Market Structure and Design,* Docket No. RM01-12 (Feb. 7, 2002).

[57] See *California State Auditor*, "California Energy Markets: Pressures Have Eased, But Cost Risks Remain" at Table 1, p. 35. The report is available at http://www.bsa.ca.gov/bsa/pdfs/2001009.pdf.

In vertically integrated utilities, fossil fuel facilities were operated as load following facilities (compared to base load facilities like nuclear power plants that run at relatively fixed outputs) that would increase or decrease output as needed. Under the anti-competitive conditions prevailing at the time of contract negotiations, the suppliers with fossil fuel generating units had the ability to force the CDWR to deviate from prudent industry convention in an effort to maximize realization of the artificially inflated market prices. From both a financial and reliability perspective California suffers for this exercise of market power. CDWR will be consistently confronted with amplified surplus power during low load that far exceeds the volume typically associated with balancing electric systems. Such surplus power will need to be sold at a loss, if it can be sold at all. More troubling, non-dispatchable block contracts with load following facilities create reliability problems because those facilities are no longer available to dispatch up and down to balance the system. During relatively low periods of demand, no other facilities may exist to reduce output. This reality will distort California's ability to manage congestion by either forcing the grid operator to shed load or escalating costs in the balancing market above competitive levels. Consequently, the California Board submits that the absence of provisions allowing for dispatchability of CDWR's block contracts is unjust and unreasonable and demonstrates the existence of market power.

2. Provisions Prohibiting or Effectively Evading or Nullifying the Effect of FERC Review

A number of sellers attempted to evade Commission regulation by inclusion of provisions that purport to preclude challenges to the contracts, prevent Commission review of the contracts, or both. These provisions are unjust and unreasonable and must be stricken from each challenged contract in which it appears.[58]

No party can contract away the Commission's right and obligation to determine whether particular rates, terms, and conditions are just and reasonable. See e.g. *Connolly v. Pension Benefits Guarantee Corp.,* 475 U.S. 211, 223-24 (1986) ("If [a] regulatory statute is otherwise within the powers of Congress, therefore, its application may not be defeated by private contractual provisions"); Restatement of the Law, Second, Contracts, §§ 178, 181. The paramount obligation of the Commission under the FPA is to protect consumers from excessive rates. *City of Detroit v. FPA,* 230 F.2d 810, 817 (D.C. Cir. 1956). Accordingly, any private arrangement that would compel consumers to bear unjust and unreasonable rates pursuant to §§ 205 and/or 206 would violate the central purpose of the FPA and must be unlawful. [59] Moreover, the highly onerous and one-sided

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[58] See, e.g., §§12.02 and 12.20 CalPeak Agreements (Exhibits 22-28) (rates under the Agreement "shall not be subject to change through application to FERC pursuant to the provisions of Section 205 or 206 of the FPA"); § 10.13 Allegheny (Exhibit 32) ("any Governmental entity" that institutes an action which results in reductions in the pricing terms of the agreement purports to allow the seller to terminate the agreement without penalty and, if the challenging party is an "affiliate" of CDWR, then the contract purports to provide Allegheny with rights to a termination payment equivalent to the anticipated profits across the life of the contract.); § 10.14 Calpine 1 and Calpine 2 (Exhibits 2 and 4) (the Commission may not change the rates, terms or conditions of the Agreement pursuant to application under section 205 or 206 by "the State of California and any of its agencies"); § 6 Mirant Agreement (Exhibit 11); § 11.1.5 Pacificorp Agreement (Exhibit 21); § 10.03 Sempra Agreement (Exhibit 12); §§ 10.13 and 5.5(e) Wellhead-Gates and Wellhead-Panoche Agreements (Exhibits 29-30); and § 10.14 Williams Agreement (Exhibit 14).

[59] Several contracts contain patently unlawful terms that go far beyond any attempt to avert regulatory oversight. Section 5.7(b) and (c) of the GWF Agreement purports to provide that in the event that, as a result of the action of "any person or entity at the direction of the State of California or any agency thereof" or any third party, the Commission finds that the prices charged under the agreement are unlawful, "Seller shall be entitled to collect from Buyer as liquidated damages for such action, payment in an amount equal to the difference between the original Contract Price contained herein and the Contract Price resulting from such reduction and/or refund." (Exhibit 9.) Simply put, GWF attempts to ensure that it will nevertheless reap the benefits of an adjudicated unlawful price. California law, which govern disputes under the contracts, does not permit such unjust enrichment. *Asdourian v. Araj,*38 Cal. 3d 276, 291(1985) ("Generally a contract made in violation of a regulatory statute is void"); *Wilson v. Sterns,* 123 Cal.App.2d 472 (courts will not permit party to an illegal contract to be unjustly enriched).

nature of the provisions provide tangible proof that sellers were exercising a high degree of market power at the time CDWR seeking to secure California's much needed power.

3. Provisions Subordinating Bond Priority

Payments under the contracts are highly secure. The provisions of California Water Code sections 80110 and 80134(a)(2), which entitle CDWR to recover as a revenue requirement "[t]he amounts necessary to pay for power purchased by it." The California Public Utilities Commission has taken steps to ensure proper implementation of the Water Code provisions.[60] Yet, many of the contracts demand payments preference over repayment of the bonds to be issued to finance the contracts under the statutory scheme of AB1X.[61] For instance, § 3.6 of the GWF Agreement provides that payments under the agreement shall be "payable prior to all Bonds, notes or other indebtedness secured by a pledge or assignment of the Trust Estate." This is not a standard commercial credit protection clause. The Edison Electric Institute ("EEI") Master Power Purchase & Sale Agreement, for instance, which specifically includes provisions credit specifically designed for use with governmental entities, does not provide for subordinating bond payments. These types of clauses potentially, and needlessly, limit the type of financing and therefore are likely to raise financing costs available to the State. Thus, the provision unduly burdens to State without adding any material protection to the suppliers and should be struck as unjust and unreasonable.

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[60] *Opinion Adopting a Rate Agreement Between the Commission and the California Department of Water Resources,* CPUC D02-02-051 (2002) and D02-02-052 (2002).

[61] E.g., Sempra, § 10.21 (Exhibit 14); Calpeak (Exhibits 22-28), § 10.25; Constellation, § 3.14 (Exhibit 5); High Desert, § 3.14 (Exhibit10); Allegheny 1, § 3.7 (Exhibit 32); PacifiCorp, § 16.15 (Exhibit 21); Fresno, § 10.2(b) (Exhibit 31); Wellhead-Gates and Wellhead-Panoche (Exhibits 29-30), § 10.2(b); Mirant Confirmation Agreement Exhibit A (Exhibit 11); Morgan Stanley, § 3.8 (Exhibit 12); Williams, § 3.8 (Exhibit 16); Alliance, § 3.8 (Exhibit 1); Coral, § 10.2 (Exhibit 6); PGET, § 3.7 (Exhibit 33); and Sunrise, § 6.9 (Exhibit18).

4. Creditworthiness Provisions

As recently noted in the January 29, 2002 testimony of FERC Chairman Pat Wood III before the United States Senate Committee on Natural Resources, "[creditworthiness] provisions may be subject to Commission review for justness and reasonableness."[62] The recent bankruptcy of Enron highlights that creditworthiness standards are a material element of ensuring contractual performance. Yet, the contracts provide CDWR with virtually no protection from future financial mismanagement by CDWR's suppliers. The contracts abandon the commercial standards embodied by the Master EEI and WSPP agreements[63] and, instead, impose strict burdens on only one party to the transaction -- CDWR. These provisions are unjust and unreasonable and must be revised.

The asymmetrical requirements impose a burden on CDWR that an Event of Default will occur if the Bonds issued by the State to pay off the contracts fall below a certain credit rating by the bond agencies, but generally fail to impose a similar responsibility on the sellers to maintain long-term credit ratings above a certain level. For example, the Mirant agreement exempts both parties from the creditworthiness requirements embodied in Section 27 of the WSPP Agreement, but then grants Mirant the right to terminate the agreement if DWR fails to obtain a rating of "BBB- or better by S&P or Baa3 or better by Moody's" on the Bonds or the Special Fund established to pay sellers, without granting CDWR a similar right if Mirant is downgraded to junk bond

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[62] January 29, 2002 testimony of FERC Chairman Pat Wood, III before the United States Senate Committee on Natural Resources, p. 13.

[63] See, §5.1(d) of the EEI Master Agreement; §22.1(c) of the WSPP Agreement.

status, as has indeed occurred.[64] The Allegheny 1 agreement declares on the Cover Sheet that Credit Assurances of Article Eight are "not applicable" to either party, but then grants Allegheny an additional, conditional termination right if CDWR fails by March 31, 2002 (the first anniversary of the effective date of the agreement) to issue bonds "of no less than three (3) billion dollars, whose long-term unsecured senior debt is rated BBB or better by S&P, and Baa2 or better by Moody's."[65] CDWR possesses no similar right under the agreement with Allegheny. These examples are not isolated. Other contracts include similarly one-sided credit provisions.[66]

The absence of any creditworthiness requirement imposed on sellers threatens the viability of the projects, particularly where supply is contemplated from the construction of new generation units. If creditworthiness prevents realization of delivery of contracted for supply, CDWR must be able to terminate the agreements. In fact, the very inability of

[64] Mirant Confirmation Agreement, Exhibit A, §§1(a), 1(f) (Exhibit 11).

[65] Allegheny, Cover Sheet Article 8, and § 10.13 (Exhibit 32).

[66] The Williams agreement similarly provides that credit assurances were not applicable, but granted Williams a termination right for failure of CDWR to issue bonds at a certain bond rating, but no similar right to CDWR for any downgrade of Williams' credit. Williams, Cover Sheet Article 8, and § 3.16 (Exhibit 16). The Constellation, High Desert and Morgan Stanley contracts also declare on the respective Cover Sheets that Credit Assurances of Article Eight are "not applicable" to either party, but each have additional termination provisions if the CDWR Bonds fall below creditworthy status, without imposing any such rights for CDWR if sellers are downgraded. Constellation, Cover Sheet Article 8, and § 3.15 (Exhibit 3); High Desert, Cover Sheet Article 8, and § 3.15 (Exhibit 10); and Morgan Stanley, Cover Sheet Article 8, and § 10.13 (Exhibit 12). The Calpine 2 agreement declares credit assurances as not applicable, but the agreement has a condition precedent requiring a high bond rating for CDWR's financing or else Calpine can terminate the agreement (albeit without receiving a termination payment). Calpine 2, §3.7 (Exhibit 4). The Pacificorp agreement similarly imposes creditworthiness requirements on the Bonds maintained by CDWR, the failure of which accelerates payments by CDWR to Pacificorp, but no such creditworthiness requirements are imposed upon Pacificorp. Pacificorp, §8.2 (Exhibit 21). The Sunrise cover sheet checks off "not applicable" for both parties for creditworthiness requirements under Article 8, but states that a "downgrade event" is applicable against CDWR, and establishes specific downgrade events against CDWR including downgrading of the bond rating, the violation of which gives Sunrise the ability to declare an Event of Default. Sunrise, Cover Sheet Article 8 and § 8.2. (Exhibit 18.) The Fresno Cover Sheet states that it has no creditworthiness protections against CDWR under Article Eight, but adds an additional termination provision if CDWR bonds are not maintained at a certain credit level, while only granting CDWR a subordinated lien on Fresno's property in return. Fresno, Cover Sheet Article 8 and § 5.5(b), § 8 (Exhibit 31).

CDWR to negotiate commercially reasonable credit safeguards manifests the market power wielded by the generators. If the Commission does not abrogate the contracts completely, it must modify those contracts with asymmetrical credit provisions currently in favor of sellers so that the symmetrical creditworthiness requirements are imposed upon both sellers and CDWR.

5. Most-Favored Nations Provisions

Virtually all of the contracts include a "most-favored nations" clause with respect to credit and security provisions, and thus may be unjust and unreasonable.[67] The Supreme Court long ago declared such clauses to be "incompatible with the public interest." *Permian Basin Area Rate Cases,* 390 U.S. 747, 782-83 (1968). These provisions must be stricken from each challenged contract in which they appear.

6. Allocation of Risk of Future Governmental Action

Generally, power purchase agreements allocate risks by the point of delivery – costs up to the point of delivery are borne by the seller, and all costs after the point of delivery are borne by the buyer. The market power of the suppliers altered the standard risk distribution in a manifestly unjust and unreasonable manner by imposing on CDWR the risks of increased costs arising from actions of governmental entities, without restriction to those under the State's control.

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[67] See, e.g., Allegheny § 3.9 (Exhibit 32): "No More Favorable Terms/Negative Pledge. Party B shall not provide in any power purchase agreement payable from the Trust Estate for (i) collateral or other security or credit support with respect thereto, (ii) a pledge or assignment of the Trust Estate for the payment thereof, or (iii) payment priority with respect thereto superior to that of Party A, without in each case offering such arrangements to Party A." See also Calpine 1, § 8.5; Calpine 2, §, 3.11 and § 3.14 (Exhibit 2 and 4); Constellation, § 3.9 (Exhibit 5); El Paso, § 3.10 (Exhibit 8); High Desert, § 3.9 (Exhibit 10); Morgan Stanley, § 3.10 (Exhibit 12); Williams, § 3.10 (Exhibit 16); Alliance, § 3.10 (Exhibit 1); Coral, § 3.10 (Exhibit 6); GWF, § 3.8 (Exhibit 9); PGET, § 3.9 (Exhibit 32); Sempra, § 10.20 (Exhibit 14); Calpeak, § 12.23 (Exhibits 22-28); Fresno, § 3.8 (Exhibit 31); PacifiCorp, § 16.17 (Exhibit 21); and Wellhead-Gates and Wellhead-Panoche, § 3.8 (Exhibits 29-30).

The Dynegy and Williams contracts provide the most egregious examples of supplier overreaching. For example, in the Dynegy contract, the parties acknowledged that performance of the contract for year 2001 could cause Dynegy to exceed applicable air emission limitations. As such, for this year, CDWR is deemed responsible for 100 percent of these costs, whether or not the contract causes Dynegy to exceed its limits. While this provision is potentially reasonable, the contract then imposes an unreasonable burden on the CDWR. For the remaining duration of the contract, CDWR must compensate Dynegy for all air emission costs attributable to performing the contracts. This provision potentially saddles the CDWR for 100 percent of air emission costs arising from operation of the units even if the CDWR's contracts were executed before other contracts that increase Dynegy's air emission expenses.

The Williams contract is particularly onerous. Except in the short term, the contract grants Williams the discretion to designate the units to provide power to CDWR. Not all Williams-owned units have equal emission rates. Thus, unless Williams' agreements with other purchases contain similar provisions, Williams will have an incentive to generate CDWR's power using units with the highest emission rates because those costs will be covered. Moreover, the Williams contract provides that CDWR is responsible for increases in costs that result from "any governmental action or inaction other than by a Governmental Entity" and "any action or inaction by a Governmental Entity."[68] In other words, the Williams contract passes the cost risk of any governmental action to CDWR, regardless of whether the increased cost resulting from the

[68] A "Governmental Entity" is defined as "a public power system, the State of California, any municipality, county, governmental board, public power authority, public utility district, joint action agency, or other similar political subdivision or public entity of the State of California, the State Department of Water Resources, or any combination thereof."

governmental action is imposed directly or indirectly on the power supplier and regardless of whether the governmental action is by a California governmental entity or some other governmental actor outside the State.

A purported market that fully insulates a party from the risk of doing business is not competitive. Accordingly, onerous provisions produced by such anticompetitive market are unjust and unreasonable and must be stricken.

VII.

REQUEST FOR RELIEF

For the reasons set forth above, the Oversight Board requests that each of the contracts that is subject of this complaint be ordered void and unenforceable under their present terms, and on a schedule that will avoid creating a new round of unequal bargaining power and uncertain reliability. Specifically, the Oversight Board requests that the Commission order each of the contracts voidable at the option of the buyer by a date certain, or alternatively, abrogated as of a date certain, in either case perhaps 120 days from the issuance of the Commission's order, and allow for the execution of replacement contracts during that period. The Oversight Board believes that such instruments, negotiated now that effective measures have been instituted to restore near-term order to the market, could be created under fair and equal bargaining conditions and reflect an appropriate outcome for the public. Each of the challenged contracts is unjust and unreasonable with respect to price and to non-price terms and conditions and abrogation is justified. In the alternative, the Commission must order reformation of the challenged contracts to provide for just and reasonable pricing, a reduced duration, and removal of unreasonable non-price terms and conditions, including those provisions identified herein.

VIII.

ADDITIONAL INFORMATION TO COMPLY WITH RULE 206

The following information is submitted in compliance with the requirements of Rule 206(b) of the Commission's Rules of Practice and Procedure.[69]

Rule 206(b)(1)-(2): Clearly identify the action or inaction which is alleged to violate applicable statutory standards or regulatory requirements; explain why the action or inaction violates applicable statutory standards or regulatory requirements.

These matters are set forth in summary at pages 2-5 and in detail at pages 21-41, but generally relate to the exercise of market power by public utility sellers resulting in unjust and unreasonable rates stemming from the terms and conditions in the long-term power contracts entered into between these sellers and the State of California.

Rule 206(b)(3): Set forth the business, commercial, economic or other issues presented by the actions or inaction as such relate to or affect the complainant.

The Board does not have any direct business, commercial or economic interests affected by the actions or inaction alleged herein. Rather, the California Board's interest arises from its statutory mandate to oversee, on behalf of the State of California and its citizens, the CAISO including the markets administered by the CAISO and the reliable operation of the transmission grid. As described at pages 31-34, the California ratepayers suffer a direct significant adverse financial impact as a result of the long-term power contracts challenged herein. Also, as described at pages 34-35, reliable transmission grid operations are threatened as a result of the terms and conditions of the contracts challenged herein.

Rule 206(b)(4): Make a good faith effort to quantify the financial impact or burden (if any) created for the complainant as a result of the action or inaction.

See answer to Rule 206(b)(3).

Rule 206(b)(5): Indicate the practical, operational, or other nonfinancial impacts imposed as a result of the action or inaction, including, where applicable, the environmental, safety or reliability impacts of the action or inaction.

These matters are set forth at pages 34-42.

Rule 206(b)(6): State whether the issues presented are pending in an existing Commission proceeding or a proceeding in any other forum in which the complainant is a party, and, if so, provide an explanation why timely resolution cannot be achieved in that forum.

No proceeding is pending before the Commission that entirely addresses the misconduct of public utility sellers alleged herein relating to the long-term power contracts entered into by the State of California that are described herein. Allegations relating to market power, unjust and unreasonable prices in the CAISO and the (former) CalPX energy and ancillary services markets, and measures to mitigate uncompetitive behavior in California are the subject of Docket Nos. EL00-95, et al. Also, some of the Respondents have filed their long-term contracts with the Commission and certain of these contracts have been protested by the California Board, among others, on the basis of unjust and unreasonable prices, terms and conditions. However, certain public utility sellers (i.e. power marketers) are not required by Commission regulation to file their contracts for power sales and, consequently, no other forum exists aside from the instant complaint exists in which to address these contracts. Also, the Commission has made it clear that a complaint filed under Section 206 of the FPA is the appropriate procedural vehicle to raise concerns over long-term agreements entered into by public utility sellers

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[69] 18 C.F.R. § 385.206(b).

that have market-based rate tariffs on file with the Commission (see *Pacificorp Power Marketing*, 97 FERC ¶ 61,105 (2001)).

Rule 206(b)(7): State the specific relief or remedy requested.

The specific relief sought is addressed on page 42.

Rule 206(b)(8): Include all documents that support the facts in the complaint in possession of, or otherwise attainable by, the complainant, including, but not limited to, contracts, affidavits and testimony.

The Board has provided citations, and, where appropriate and available, supporting exhibits and testimony.

Rule 206(b)(9): State (i) whether the Enforcement Hotline, Dispute Resolution Service, Tariff-based dispute resolution mechanisms, or other informal procedures were used; (ii) whether the complainant believes that alternative dispute resolution (ADR) under the Commission's supervision could successfully resolve the complaint; (iii) what types of ADR procedures could be used; and (iv) any process that has been agreed on for resolving the complaint.

The Board has not utilized any of the Commission's alternative dispute resolution (ADR) services described in Rule 206(b)(9) and believes that the nature of this complaint is such that ADR would not be useful.

Rule 206(b)(10): Include a form of notice suitable for publication in the *Federal Register* and submit a copy of the notice on a separate 3 ½ inch diskette in ASCII format.

A form of notice, in paper and electronic form, is attached to the complaint.

Rule 206(b)(11): Explain with respect to requests for Fast Track Processing pursuant to Section 385.206(h), why the standard process will not be adequate for expeditiously resolving the complaint.

The Board is not requesting Fast Track Processing.

V.

CONCLUSION

WHEREFORE, for the foregoing reasons, the California Board respectfully requests that the Commission grant the relief requested herein.

Dated: February 25, 2002

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused Volume 1 of the Complaint to be served upon each respondent identified in Appendix A to this Complaint on February 25, 2002, pursuant to Rule 2010(a) of the Commission's Rules of Practice and Procedure. Separately filed Volumes 2-5 of this Complaint are available to each respondent upon its request.

Dated at Sacramento, California, this 25th day of February, 2002.

Grant A. Rosenblum
Electricity Oversight Board
770 L Street, Suite 1250
Sacramento, CA 95814
(916) 322-8601

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Electricity Oversight Board, Complainant v. Sellers of Energy and Capacity Under Long-Term Contracts With the California Department of Water Resources, Respondents	)	Docket No. EL02-____-000

NOTICE OF COMPLAINT

(February __, 2002)

Take notice that on February 25, 2002, the California Electricity Oversight Board (Complainant) filed a complaint against specified sellers of long term power contracts to the California Department of Water Resources (Respondents) alleging that the prices, terms, and conditions of such contracts are unjust and unreasonable and not in the public interest. Complainant alleges that Respondents obtained the prices, terms, and conditions in the contracts through the exercise of market power, in violation of the Federal Power Act, and that the prices, terms, and conditions are causing injury to the citizens and ratepayers of California and the State's economy.

Copies of this filing were served upon Respondents and other interested parties.

Any person desiring to be heard or to protest this filing should file a motion to intervene or protest with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 CFR 385.211 and 385.214). All such motions or protests must be filed on or before _______________, 2002. Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding.

Any person wishing to become a party must file a motion to intervene. Answers to the complaint shall also be due on or before ___________, 2002. Copies of this filing are on file with the Commission and are available for public inspection. This filing may also be viewed on the web at http://www.ferc.gov using the "RIMS" link, select "Docket#" and follow the instructions (call 202-208-2222 for assistance). Comments, protests and interventions may be filed electronically via the Internet in lieu of paper. See, 18 CFR 385.2001(a)(1)(iii) and the instructions on the Commission's web site under the "e-Filing" link.

Magalie Roman Salas

Secretary